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SUBJECT: Changing Face of Canadian Auto Sector

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Sensitive But Unclassified - Please Protect Accordingly.

¶1. (SBU) Summary: An ascending Canadian dollar, briefly topping US$1.10 for the first time in modern history on November 7 and still at US$1.04 as of November 14, continues to put pressure on the Canadian auto manufacturing sector, and to erode its global competitiveness. Canadian Auto Workers (CAW) union President Buzz Hargrove has renewed his opposition to the proposed Canada-Korean Free Trade Agreement (FTA), which he says would make matters worse (ref (A)). Ontario manufacturers are calling for a cut in interest rates to help take some of the air out of the loonie, but market analysts are concerned that such a move will only fuel consumer spending and borrowing. Soaring relative costs determined in Canadian dollars, diminished U.S. demand, and higher fuel costs changing consumers' preferences, have forced more layoffs at Chrysler Canada, and the parts sector is expected to be next. On November 7, CAW workers signed a deal with parts supplier Magna, giving the unionized employees at Magna's Windsor Modules plant more job security. End Summary.

¶2. (U) Canadian vehicle sales were up 2% to 121,237 in October, compared with 118,833 in October 2006, compared to a 2% drop from September 2006 to September 2007. Chrysler Canada, Ford Canada, and GM Canada all outperformed the market for the first time in three years, with GM up 13%, Ford 6%, and Chrysler 3%. The Detroit Three outshone their Japanese competitors after offering incentives to car buyers, which included cash rebates of up to C$5,250 at Chrysler and C$7,000 at Ford. Honda Canada's sales were down 9%, and Toyota Canada sales were down 10%. That contrasted with the United States, where rising gas prices reportedly drove up U.S. sales for small cars, including Toyota, thereby apparently creating a shortage of small cars for sale in Canada (where small car sales had been very strong until last month).

¶3. (U) Early in November, Honda Canada responded with incentives as high as C$5,500 for cash purchases of the Pilot crossover vehicle; C$1,500 to buyers of the compact Civic; and up to C$4,000 on some models of the Accord. On November 8, GM Canada, Canada's biggest automaker, joined its competition in offering rebates of C$1,500 to C$10,000 on select models. GM also announced that it will cut its own collection of the goods and services tax (GST) by 1% until January, when the GST will be officially lowered from 6% to 5% by the federal government.

Cross-Border Auto Shopping Continues

¶4. (SBU) Despite sales incentives by the Canadian auto sector, the high-flying Canadian dollar and lower U.S. list prices are attracting more Canadian shoppers daily, according to the Registrar of Imported Vehicles. 25,000 Canadians bought U.S. vehicles in October, and it is estimated that 170,000 Canadians will buy a vehicle in the U.S. in 2007. The previous one-year record for the number of Canadians buying U.S. vehicles was 112,000. 40% of the vehicles purchased in the U.S. by Canadians are expected to be new, rather than used. An industry insider told us that most of the cars being imported from the U.S. into Canada are used cars because it is difficult for Canadians to finance new cars in the U.S.; purchases therefore tend to be in cash. 5,000 Canadians reportedly call the registrar per day looking for information on importing cars from the U.S. When the Canadian dollar hit US$1.08 last week, that number rose to 7,000.

Chrysler Announces More Job Losses

¶5. (U) On November 1, Chrysler Canada announced it plans to eliminate 1,100 jobs (roughly one shift of workers) at its Toronto Area plant in Brampton. This downsizing is in line with recent workforce reductions at Ford in St. Thomas, Ontario and GM in Oshawa, Ontario, though Chrysler has not trimmed as many jobs at its Canadian operations as have Ford and GM in the last year or two. In August, GM announced that it would eliminate 1,200 of the 3,000 jobs at its truck plant in Oshawa by January 2008 due to diminishing U.S. demand. 85% of the trucks assembled at the Oshawa plant are destined for sale in the U.S. Another 3,000 jobs will be eliminated over the next two years at GM's Oshawa car plants. This year, Ford has shed 3,000 jobs by closing its Essex Engine Plant in Windsor, and eliminating one shift at its St. Thomas assembly plant (ref (D)). Chrysler's announced cuts are in addition to its elimination

of 2,000 jobs in Canada by 2009, announced at the beginning of this year (ref (C)). Most of those cuts affected Chrysler's Windsor assembly plant (ref (C)).

¶6. (U) Chrysler also plans to discontinue four of its models that have shown a consistent decline in sales; including the Dodge Magnum muscle car and the Chrysler Pacifica crossover, which are built in Brampton and Windsor, respectively. Magnum sales slid 27% through the first 10 months of 2007. The axing of the Pacifica will eliminate an additional 200 jobs later in November at Chrysler's Windsor assembly plant. The Brampton layoffs are expected to start in February 2008. In February of this year Chrysler announced plans to build the Dodge Challenger "muscle car" at its Brampton plant starting in 2008 (ref (C)).

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Canadian Auto Workers (CAW) Union Calls for Assistance
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¶7. (SBU) CAW President Buzz Hargrove has again called on the Canadian federal government to immediately end free trade talks with Korea and implement restrictions on imports from Korea and Japan until Canadian exports are given fair access abroad (ref (A)). Federal and provincial government officials reportedly responded to calls for assistance for the auto sector by saying the auto industry must adapt to the demands of North American consumers for more fuel-efficient and environmentally friendly vehicles.

Parts Suppliers May Be Next to Feel Pain

¶8. (U) Concerns are mounting that the recent deals struck in the U.S. between the UAW and Chrysler, GM, and Ford may impact Ontario-based Magna and other parts suppliers. Some are speculating that the terms of these collective agreements may prompt GM, Ford, and Chrysler to in-source production of components and modules that are currently being produced by independent auto parts

manufacturers. Magna co-CEO Don Walker recently suggested that suppliers with weak financials would be dropped before strong performers such as Magna, which reported a Q3 profit of US$155 million. Guelph, Ontario-based parts supplier Linamar, a darling of Bay Street, may be hit hard by the collective agreements. Magna, in an effort to remain globally competitive with a softening North American market, has already shut down some Canadian factories, moving production offshore.

¶9. (U) On November 7, the CAW and auto parts supplier Magna ratified a three-year agreement which increases hourly wages from C$12 to about C$15 at Magna's Windsor Modules plant. This is the first plant agreement formally ratified after the October 15 Magna/CAW announcement that the CAW would begin organizing Magna plants. Over the length of the deal, wages at the Modules plant, which supplies door components to Chrysler factories in Windsor, will rise to about C$17.85 per hour, still far from the more than C$30 per hour (C$70 per hour with pension benefits) paid at other CAW Chrysler, Ford, and GM plants. 87% of Magna's 250 hourly workers ratified the deal known as the Framework of Fairness agreement. Under the agreement, workers have given up their right to strike, a contentious point that has met with strong criticism from many CAW members, but the CAW has secured layoff and job security provisions, which are new benefits for Magna employees. On November 7, a Magna official told reporters that the agreement is "neither positive nor negative for Magna and will have no impact on profitability." A CAW official said it will try to organize another 40 plants in the Magna system, but some Magna workers oppose the deal.

¶10. (SBU) On November 12, Magna's Russian partner, Russian Machines, said that Magna will build a US$500 million manufacturing plant in Russia that will produce 150,000 Chrysler vehicles annually for consumption in that country; a Magna spokesperson called the report speculative. Today, the Russian automobile market is roughly the same size as Canada's (1.9 million autos sold in 2006), but is expected to grow larger than Germany's auto market by 2016. In March 2007, Chrysler reportedly indicated its plan to expand its global presence outside of North America to offset slowing demand at home. 9% of Chrysler's sales come from international markets; it currently has no production in Russia.

¶11. (SBU) Comment: While the soaring Canadian dollar continues to put pressure on the Canadian auto sector, market watchers agree that it is not easy to target manufacturers to help them out. The Canadian dollar hit US$1.10 in morning trading on November 7, and has settled to US$1.04 on November 14. On November 7, Ontario

Premier Dalton McGuinty called on the Bank of Canada to lower interest rates to curb the rise of the Canadian dollar. The Bank of Canada is keeping an eye on inflation but officials believe an interest rate cut could overheat Canada's currently hot commodity-driven economy. Finance Minister Dwight Duncan told reporters November 7 that the Ontario government will continue working to support the manufacturing sector. The provincial government may include an announcement to help the struggling automotive sector in the upcoming Liberal throne speech to the new Ontario Legislature on November 29. End Comment.

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